No. 86-206

Supreme Court, U.S.
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In The
Supreme Court of the United States
October Term, 1986

William W. Martin, Robert E. Mosher, and the Legal Action Committee for Marlin Investments,

Petitioners,

v.

Gilbert Robinson, Trustee in Bankruptcy,

Respondent.

PETITIONERS' REPLY TO OPPOSITION OF RESPONDENT GILBERT ROBINSON, TRUSTEE IN BANKRUPTCY

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REPLY TO OPPOSITION OF RESPONDENT GILBERT ROBINSON

INTRODUCTION

Apart from the Respondent Trustee's (the "Trustee") general and continuing statements that the record below contains data and analyses which he simply failed to present to the Bankruptcy Court, some other material misstatements and omissions are found throughout his Opposition. They therefore merit special consideration.

On page ii, the Trustee questions the standing of the Legal Action Committee ("LAC"). From that point forward, with one significant exception,[1] he refers to the LAC as the "so called Legal Action Committee."

In point of fact, the Trustee's counsel stipulated that the LAC members were Objectors, "well represented" at the "fairness hearings" after the Court itself had so stated. RT 1221:5-15; See: App. "A" hereto. The decision below recognized the LAC's status as an Appellant. *In re A & C Properties,* 784 F.2d 1377, 1378 (9th Cir. 1986); Appendix to Petition ("App. Pt.") 79.

Interrelated misstatements or omissions primarily understate what the Trustee gave up and overstate what he purportedly received under the 1982 Settlement Agreement (the "Agreement"). On page 4, the listing of claims omits: 1) any reference to the "Marlin lawsuit", mentioned in Recital "H" of the Agreement; 2) most of the claims mentioned in Recital "L"; and, 3) any reference to claims

[1]On page 21, the Trustee states that: "[i]t was his [the Court's] constant and conscious concern and intent that Martin, Mosher and the LAC be given a full and fair hearing. . . ."

arising out of mismanagement of K & K, summarily alluded to in Recital "N(7)". Cf. App. Pt. at 14 and 17-19.[2]

The Trustee asserts on page 5 that the "Agreement . . . recites in great detail the specifics of numerous disputes . . . and the reasons for said Settlement." Actually, it contains neither "great detail" regarding the disputes nor "the reasons for said Settlement". See: Pt. 15-16.

He next lists as a principal benefit of the Agreement: "transfer to the Trustee of 90,000 shares of K & K's stock, valued by the Trustee at approximately $1,000,000." On page 20, this Opposition adds that such valuation was given "at the hearing on the Application."

Two major things are wrong with those assertions. First, Petitioners' counsel obtained uncontradicted testimony from the Trustee that he did not know how to value K & K's stock. RT 957:16-958:21; 1363:21-1366:8. See: App. "B" hereto.

Furthermore, the Trustee did not gain 90.000 shares over what he had in September of 1979. As Recital "L" of the Agreement states in shorthand fashion, sometime after September 30, 1979: 1) Kane and Kelly took back 40,000 shares relinquished pursuant to the 1977 Compromise; and, 2) they caused 114,839 shares to be transferred to the purported ESOT for "per share prices which were substantially below fair market value."[3] App. Pt. at 17.

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[2]For descriptions of those omitted claims the Court is referred to pages 8 through 10 and 23 of the Petition herein and pages 45 through 48 of the Appendix thereto.

[3]Reading Recital "O" with Paragraph 1.3.3, one finds that 13,705 of those "ESOT shares" had purportedly vested in Kane and Kelly by December of 1981 and another 43,506 would vest by the express terms of the Agreement. App. Pt. 20 and 22; Pt. 9-11 and footnote 10 therein. According to the Trustee's own testimony, the price was some 62-80 cents per share. See Appendix B hereto at 4-5.

ARGUMENT

I. RESPONDENT HAS MISSTATED THE CRITERIA FOR GRANTING A WRIT OF CERTIORARI.

Both in his Statement of Questions Presented and in the second paragraph of his argument, the Trustee misstates two of the grounds for granting certiorari. There is, of course, no requirement that conflicts between a lower court's decision and a prior decision of this Court or prior decisions in other Circuits involve "identical" or "exactly the same" matters.

The reason for the Trustee's odd formulation is clear. Unless established general principles regarding the manner in which compromises must be presented to a lower court and then evaluated by that court and approved—and the standards governing their review on appeal—are not general principles at all, then he must face the fact that the principles laid down in *Protective Committee for Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414 (1968) ("TMT Trailer") were not followed in any of the proceedings below.

II. RESPONDENT HAS MISSTATED LEGAL PRINCIPLES GOVERNING EVALUATION OF COMPROMISES AND RECAST THE DECISION BELOW.

The Trustee vastly broadens both the meaning and the applicability of the Ninth Circuit's *dicta* in its *per curiam* opinion in a rather trivial bankruptcy case, *In re: Blair,* 538 F.2d 849 (9th Cir. 1976). He seeks to circumscribe the general principles regarding the approval of compromises laid down in *TMT Trailer* and consistently applied other than in the Ninth Circuit.

In order to justify the proceedings below, the Trustee must also rewrite the Ninth Circuit's decision herein. Although some portions of that decision below are confusing,

it at least paid lip service to *TMT Trailer*. Where the Court of Appeals first went astray was in not heeding the condemnation of "mere boilerplate" in the *TMT Trailer*.[4] Having done so, it compounded its error by: 1) glossing over major errors in the Bankruptcy Court's "boilerplate"; 2) misreading the Agreement, the "boilerplate" and the record and finding cost-benefit analyses in them which are not there; and, 3) setting too low and imprecise standards for the analyses required.

The principal mischief in *Blair* is its suggestion that *TMT Trailer* required a "mini-trial" while other bankruptcy proceedings require something less.[5] *In re: Blair, supra* at 852. Neither *TMT Trailer*, nor any of the numerous decisions which have followed it, have required anything which can be characterized as a "mini-trial", so the distinction is both incorrect and troublesome.[6]

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[4]In *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 656-67 (1964), this Court had warned trial courts against slavishly adopting one party's findings and conclusions.

[5]The Ninth Circuit's decision in *Blair* does not support the overly expansive reading which has been given to it. The Court of Appeals in its *per curiam* disposition of that uncomplicated and relatively unimportant matter apparently did not intend to make a major pronouncement regarding bankruptcy law. *In re: Blair, supra* at 851.

[6]That *TMT Trailer* does not require anything which may be characterized as a "mini-trial" was recognized in *Newman v. Stein*, 484 F.2d 689, 691-2 (2d Cir. 1972):

"[W]e recognize that since '[t]he very purpose of a compromise is to avoid the trial of sharply disputed issues, . . .' the court must not turn the settlement hearing 'into a trial or a rehearsal of the trial' . . . . . Rather, in the words of the Supreme Court . . . it must reach an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated and 'form an educated estimate of the complexity, expense, and likely duration of such litigation . . . and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise.' "

When the Trustee erroneously states that Petitioners were asking for anything more than that he present sufficient data for the Court to make the requisite cost-benefit analysis and that it should then make such analysis, reasonably explained in a fashion permitting a meaningful review, he is seriously misstating their position. That *Blair* itself gave some recognition to the importance of such analysis is shown by the quotation on page 9 of the Opposition followed by a cryptic "Cf. Conclusion of Law No. 4." When one compares that Conclusion with the *Blair* language, it is readily apparent that Conclusion 4 is merely a hopeless jumble of words. Pt. 9, note 17.

The Trustee next gives a portion of a quotation from *Blair* followed by "Cf. Conclusion of Law No. 5." Restoring the part which the Trustee has omitted from its first sentence, it reads: "The Bankruptcy judge and the district court may, in a case such as this, give weight to the opinions of the Trustee, the parties, and their attorneys." That is very different from the referenced Conclusion which is materially wrong.[7]

The Trustee articulates the novel proposition that because various cases which followed *TMT* in one or more Circuits did not involve liquidation bankruptcies, then other Courts of Appeal would follow his expansive interpretation of *Blair* in liquidations. He overlooks the fact that *In re: W.T. Grant,* 699 F.2d 599, 605-6 (2d Cir. 1983), cited in the Petition, was not only a major liquidation bankruptcy which followed *TMT,* but contained a lengthy footnote 9 which justified the adoption of "most" of the proposed findings and conclusions on the limited ground that the

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[7] "Where, as in this case, a compromise has been negotiated in good faith by a Trustee, and is reasonably believed by him to be the best compromise negotiable under the facts of a given case, the court should approve the recommended settlement." App. Pt. 72-3.

Bankruptcy Court also prepared its own 27 page analysis. The fact that the Eighth Circuit applied *TMT Trailer* in a failed Chapter XI proceeding, *In re: Flight Transportation Corp. Securities Litigation*, 730 F.2d 1128, 1135 (8th Cir. 1984) is not mentioned, but the Trustee cites an earlier District Court decision as "proof" that the Eighth Circuit would follow *Blair*.[8] The Trustee has failed to find any other decisions which adopt his expansive interpretation of *Blair* or validate Conclusions of Law 4 and 5.[9]

III. RESPONDENT WOULD CAST ASIDE A FUNDAMENTAL STANDARD FOR EVALUATION OF COMPLEX SETTLEMENT AGREEMENTS IN FAVOR OF VAGUE CRITERIA WHICH CANNOT BE APPLIED LOGICALLY AND CONSISTENTLY.

In two brief paragraphs on pages 14 and 15, the Trustee slides over the fact that he, the Bankruptcy Court and the Ninth Circuit have failed to apply the principle that an evaluation of the probability of success on the merits is of paramount importance in the evaluation of the fairness of

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[8]*Matter of Orrin A. Ericson*, 6 B.R. 1002, 1010 (D. Minn. 1980), illustrates the mischief which may be caused by artificial distinctions between proceedings under different sections of the Bankruptcy Act. In *Ericson*, which cited *Blair*, the District Court held that: "The policies underlying Chapter X is designed for large, publicly-held corporations. . . . *Chapter XI is designed for small businesses. . . .*" (Emphasis added). That distinction would come as something of a surprise to parties who have had interests in the reorganization proceedings of Continental Airlines and Johns-Manville.

[9]Even if there were any such cases in ordinary liquidations, they would be of doubtful applicability herein. *A & C Properties* involved a complex Settlement which affected interests in the stock, claims and control of a viable corporation, K & K Properties, having net assets of some $25,000,000 and not itself the subject of bankruptcy claims. There was clearly no terminal situation calling for a hasty liquidation.

any compromise. *TMT Trailer, supra* at 424-5.[10] The failure of the Trustee, his counsel and the courts in the proceedings below to follow the clear directions of this Court in *TMT Trailer* are the primary cause of the difficulties, expenses and delays in this matter.

What the Trustee does on pages 14 and 15 is concede that the Ninth Circuit does not recognize that, in considering whether a settlement is fair and reasonable, the probability of success on the merits is the most important factor. He also endorses the position taken in *Officers for Justice v. Civil Service Comm'n*, 688 F.2d 615, 625 (9th Cir. 1982), i.e., that the relevant factors to be considered and the weight to be assigned to each in determining the fairness of compromises are to be divined by the court on a case by case basis without any meaningful standards for guidance. The result is to give such court virtually absolute discretion in approving settlements and to prevent meaningful appellate review.[11]

The foregoing position is contrary to the generally accepted rule articulated in *Newman v. Stein, supra* at 693.[12]

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[10]As this Court has said:

"There can be no informed and independent judgment as to whether a proposed compromise is fair and equitable until the bankruptcy judge has apprised himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. . . . *TMT Trailer, supra* at 424.

[11]As the Court of Appeals said in *Matlovich v. Secretary of the Air Force*, 591 F.2d 852, 856 (D.C. Cir. 1978): "The absence of articulated standards, policies, or considerations—plus the absence of any reasoned explanation in this particular case—makes it impossible to decide whether or not there has been an abuse of discretion. . . ."

[12]"[V]ery likely all that is meant when appellate courts speak of the trial judge's discretion in this context is that in any case

(Continued on next page)

In the present matter, the absence of any cost-benefit analyses of the Agreement by either the Trustee or the Bankruptcy Court prevented the Ninth Circuit from determining whether the compromise came within a range of reasonableness.

IV. RESPONDENT'S OPPOSITION ESTABLISHES THAT HE GAVE NO COST-BENEFIT ANALYSIS.

The Trustee actually confirms that he gave no cost-benefit analysis. Beginning on page 17, he summarizes his case-in-chief. App. Pt. 56-61. He then notes that K & K's President believed that the Agreement was the "best possible under the circumstances from K & K's standpoint", but also admits the existence of a conflict of interest between the Trustee and the Directors that he had named.[13]

Additionally, the Trustee states that the Agreement was endorsed by a Teamsters' local which was the "largest *unsecured* creditor. . . ." (Emphasis added), adding a quotation from a Memorandum which it filed.[14]

(Continued from previous page)

there is a range of reasonableness with respect to a settlement—a range which recognizes the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion—and the judge will not be reversed if the appellate court concludes that the settlement lies within that range."

[13]"Obviously, the Directors negotiated on behalf of K & K, while the Trustee acted on behalf of A & C, which was a principal, but not sole, shareholder in K & K." See also: Opposition at page 3, last paragraph. Virtually all of the shares of K & K not held by the Trustee were held by Kane and Kelly, or purportedly held by the ESOT. App. Pt. 19-20.

[14]Such memoranda are not evidence of the costs and benefits of a compromise, nor was the Local able to represent what the "vast majority" of creditors believed. See: *TMT Trailer, supra* at 435-40 and note 9.

The Trustee next alleges that: "The very detailed Settlement Agreement, the foregoing testimony, the Court's substantial experience in this bankruptcy case, together with substantial additional evidence before the Bankruptcy Court, provided the basis for the cost-benefit analysis which was conducted." The cursory descriptions of the claims released are readily apparent. Certain testimony having no probative value as to costs and benefits has just been dealt with. As for "the Court's substantial experience," suffice it to say that this Court gave little, if any, weight to that factor *TMT Trailer*.

One is left with unspecified "substantial additional evidence" and the Trustee's brief testimony to support the purported "cost-benefit analysis". A decision which also involved a failed Chapter XI proceeding, recently stated the correct view of the weight accorded to the type of testimony by a trustee given below: "The best interests of creditors, however, requires more than a trustee's *ipse dixit* or request for reliance on his judgment." *In re: Lion Capital Group*, 49 B.R. 163, 190 (Bkcy. S.D.N.Y. 1985).[15]

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[15]The Bankruptcy Court sustained the Trustee's counsel's objection, on the ground of relevance, to the testimony of two of Petitioner's principal witnesses who were prepared to testify, respectively: 1) to the value of K & K's shares; and, 2) that shares could not vest in an ESOT absent a Determination Letter when the ESOP made the receipt of such a letter a condition of vesting. The latter testimony was relevant to the question of the ease of recovery of the "ESOT shares" misappropriated by Kane and Kelly. Such testimony was offered as a rebuttal to the testimony of K & K's counsel which formed the basis of Finding of Fact 16 and Conclusion of Law 6 which "opened the door". R.T. 1384:17-1391:19; 1475:12-1485:15. See also: *In re Corrugated Container Anti-Trust Litigation*, 643 F.2d 195, 215 (5th Cir. 1981).

V. RESPONDENT VIRTUALLY ADMITS THAT THE BANKRUPTCY COURT: 1) MADE UNSUPPORTED FINDINGS AND CONCLUSIONS; AND, 2) FAILED TO GIVE PROPER CONSIDERATION TO PETITIONERS' OBJECTIONS.

In the absence of any evidentiary support for a cost-benefit analysis, the Trustee has cut the text of Finding of Fact 9 on page 20 and recast the Court's Finding as to what the Trustee "reasonably believed" to make it appear to be a Finding by the Court itself regarding the merits of the Agreement.[16] He goes on to quote one of the most erroneous paragraphs in the Ninth Circuit's opinion on page 20, i.e., the one which states that the Agreement contains various items such as a "cost-benefit analysis" which simply are not there. See: Pt. 15-16. That quotation is followed by another excerpt from the decision below which misstates, among other things, that the "judge had heard testimony on the value of the corporation's assets" when: 1) the Trustee's counsel had objected to valuation testimony on the grounds of relevancy; and, 2) the Trustee had admitted his inability to value the *Estate's* assets—K & K stock.

The Trustee dismisses the failure to respond to major objections made by Petitioners simply by quoting language from the decision below which tracks the Fifth Circuit's language from *In the Matter of Jackson Brewing Co.*, 624 F.2d 605, 612 (5th Cir. 1980). The important difference between the present matter and *Jackson Brewing* is that the Fifth Circuit reached its conclusion after having noted that the District Judge had issued a 33 page opinion.

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[16]Finding of Fact 9 was designed to serve as the predicate for the materially erroneous Conclusion of Law 5. Cf. App. Pt. 70-71 and 73.

Respectfully submitted,

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APPENDIX

APPENDIX A

Excerpt from Reporter's Transcript of Proceedings Dated April 8, 1982, in connection with the Fairness Hearings.

* * *

"MR. NOBLE: 'And the Martin Superior Court Cross-Complaint.' "

"THE COURT: 'And those are the two actions that are not properly described?' "

"MR. NOBLE: 'Also the Martin lawsuit in H. Our particular concerns are with F and G. And without limiting the objections that are set forth in detail in our written objections, those objections are twofold.

'One, w-r-i-t-t-e-n. They don't tell the creditors at all what they are about. *And, secondly, they don't tell 450 of the creditors—that is to say, the members of the legal action committee*—that they are A class [sic] plaintiffs in adversary D. They do not tell them that the legal action committee itself is a cross-complainant in the Superior Court action. *And they also don't tell these 450 people, the members of an incorporated association.*

'They are arguably named as defendants in the Complaint in the Superior Court action which is being released in one direct; that is to say, the agreement calls on the cross-complaint to be dismissed, but not the main action.' "

"THE COURT: 'Who is representing these cross-complainants?' "

"MR. NOBLE: 'We are.' "

"THE COURT: 'Well, haven't you told them? See, what you are complaining about is that your people haven't

been told what their lawsuits are about, if I understand you.' "

"MR. NOBLE: 'They have not been told that this is settling their lawsuit.' "

"THE COURT: 'They haven't.' "

"MR. NOBLE: 'They haven't.' "

"THE COURT: 'I see.' "

"MR. NOBLE: 'And as you know, Your Honor,—' "

"THE COURT: 'But they are well represented here today?' "

"MR. NOBLE: 'The reason there is class notice—' "

"THE COURT: 'Answer me.' "

"MR. NOBLE: 'Yes?' "

"THE COURT: *'I asked a question. Are they not well represented here today?'* "

"MR. GILL: *'I will stipulate to that.'* "

"THE COURT: *'Pardon?'* "

"MR. GILL: *'I'll stipulate to that fact, your Honor.'* "

"THE COURT: *'You are here, you are their attorney?'* "

"MR. NOBLE: *'That's correct.'* "

"THE COURT: *'So how are they being shortchanged by not being told in the Notice of Compromise about this, since you are here as their attorney?'* "

"MR. NOBLE: *'Your Honor, there are noticed procedures.'* "

"THE COURT: *'I know there are, but you represent all those people and you got noticed.'* " R.T. 1219:22-1221:24 (Emphasis added).

APPENDIX B

Excerpt from Reporter's Transcripts of Proceedings Dated February 23 and April 12, 1982, in connection with the Fairness Hearings.

"Q. [By Mr. Noble:] 'Other than the fact that they took them back, did Kane and Kelly give the corporation anything for the 40,000 shares?' "

"A. 'Not that I'm aware of.

'Unless you're referring to what Kane and Kelly did as part of the 1977 statement.' "

"Q. 'No, I'm talking about what they just went and said we want our 40,000 shares back, there was no bargaining exchange then?' "

"A. 'If there was, I was not a party to it.' "

"Q. 'You're not aware of it today, I gather?' "

"A. 'I'm not.' "

"Q. 'Do you recall what the value of those shares was when they took them back?' "

"A. 'Mr. Noble, how do you value shares of this corporation? 'I don't know how to answer your question.' "

"Q. 'You have no educated guess as to what they were worth when they took them back?' "

"A. '*Mr. Noble, I don't know how you value shares in this corporation.*

'There are many different formulas to use, many different approaches for the ESOT.

'I told you, on Page 7 of the settlement agreement they valued the shares at 62 cents. Is that the share you're looking for?

'The next paragraph on Page 7 says they valued for the ESOT purposes 80 cents a share. Is that the value you're looking for?' "

"Q. 'I'm looking for what they were really worth.' "

"A. 'I don't know what they were really worth.' " R.T. 957:16-958:21.

* * *

"Q. [MR. NOBLE:] 'At some time after your engagement of your firm's engagement on November 5th, did you form an opinion as to the value of the assets of K & K Properties?' "

"MR. GILL: *'If it please, Your Honor, I would object. The issue of the value of the properties is immaterial and irrelevant to the issues before the court, which deal with the questions of whether there were disputes which ought to be compromised and whether the compromise that has been made is in the best interests of creditors.*

'What has happened in this compromise is a block of stock has transferred. A percentage interest in ownership of the corporation is transferred from Kane and Kelly to the trustee as well as other cash considerations owing, the value of the property. Whether he's valued at the ESOP value or at some value is irrelevant. The significant part is that a significant percentage of ownership of the company has shifted. *The question of how much the stock is worth is interesting in many respects, but it does not bear on the compromise.*' "

"THE COURT: 'Mr. Noble?' "

"MR. NOBLE: 'Your Honor, I—' "

"THE COURT: 'Actually what's happened is that the balance is shifted in favor of the trustee of A & C Properties. That's as to the ownership involved. Am I incorrect on that? Somewhere we've got this laid out.' "

"MR. GILL: 'The balance has also been in favor of the trustee. The percentage interest has—' "

"MR. NOBLE: 'Your Honor, it's gone back and forth, if I can explain that.' "

"THE COURT: 'No, don't bother right now, Mr. Noble.' "

"MR. GILL: 'I think it would be fair to state that the percentage interest of the trustee subsequent to the settlement would be greater than the percentage interest of the trustee prior to the 1982 settlement.' "

"THE COURT: 'That's what I thought it was when I made my remark.' "

"MR. GILL: 'The trustee is and will be the substantial majority shareholder in any event.' "

"THE COURT: 'Mr. Noble, do you want to be heard on his objection?' "

"MR. NOBLE: 'Yes, Your Honor.

'As a portion of the settlement agreement, certain shifts occurred in ownership percentages back and forth. *The litigation which is being settled involves relinquishing causes of action related to other interests in the corporation. And as a consequence, I don't know how one gets to an evaluation of what the settlement actually does with-*

out knowing the value of the underlying assets. That has been the issue in all of these related proceedings for low these many years.'"

"THE COURT: 'Well, how are you going to settle that? You've had these for low these many years. How are you going to settle it?'"

"MR. NOBLE: 'Well, I was in hopes of Mr. Looby—'"

"MR. GILL: 'Well, Your Honor, Mr. Looby, who is Mr. Noble's witness and who is tax counsel, has certainly not been qualified as an expert appraiser, Mr. Noble knows very well, if it were material and relevant to put on evidence as to the value of the property. And this does not advance Mr. Noble's position.

'I think the Court will agree that we have been rather patient in allowing Mr. Noble wide latitude, that day after day goes by without any appreciable progress, and we have to insist upon a more technical application of the rules of evidence.'"

"THE COURT: '*All right. I will sustain the objection.*'" R.T. 1363:21-1366:8. (Emphasis added).